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20 December 1982

MEMORANDUM FOR: Dennis Lamb
Department of State

FROM: Maurice C. Ernst
NIO for Economics

SUBJECT: Comments on Revised Draft of Oil and Gas Paper

1. As I indicated in our telephone conversation, I believe this paper requires considerable additional revision. There are problems of fact, pertinence, and perspective.

2. With respect to Soviet motives for energy development, we know of no Soviet plan to expand natural gas exports into the 1990s to the amounts mentioned on page 1. I believe these numbers represent CIA projections of what Soviet gas exports could be if no alternative sources of gas for Western Europe were developed. Moreover, the Soviet motive for pushing natural gas production is straightforward: gas is the cheapest and most plentiful source of energy available to the USSR and by far the largest potential source of hard currency earnings. Development of coal is extremely expensive; oil production probably has stopped growing and its marginal cost is high. Obviously, Moscow can obtain political benefits from exporting large amounts of gas to Western Europe, but this is clearly a favorable spin-off, not a primary objective of the sale.

3. As to the forum for discussion of oil and gas technology, the

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broad strategic aspects could be considered within NATO as part of a general assessment of the impact of East-West economic relations on the Soviet economy and military capabilities. COCOM appears to be too narrow a framework for such a study.

4. We are also unclear about the second objective of the proposed study (p. 2). The connections between Allied purchases of Soviet gas and their willingness to export oil and gas equipment and technology to the USSR need to be more clearly spelled out. An Allied decision not to increase import dependence on Soviet gas would at the same time reduce Soviet demand for Western equipment, and also Soviet ability to pay for such purchases. However, not all Soviet gas projects are directly tied to exports to Western Europe. For example, the Astrakhan project is not.

5. Further clarification of the criteria for restricting exports of oil and gas equipment and technology to the USSR is needed.

- o The relationship between Soviet hard currency earnings and "military spending--adventurism--support of client states--" is indirect and uncertain. A plausible case can and has been made that foreign exchange shortfalls have an adverse impact on the Soviet economy from which defense and foreign relations programs cannot be completely insulated. But this argument smacks of what the Allies would call "economic warfare" and is unlikely to be persuasive. Moreover, the argument is relevant only in the context of an overall strategy of East-West economic relations; if a common strategy can be developed, it is not likely to be in the

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framework of COCOM.

- o A conceivable criterion for COCOM controls on oil and gas equipment and technology would be dual use. However, this criterion would not cover very many items.
- o Such controls could conceivably be justified as instruments for preventing excessive West European dependence on Soviet gas supplies. It would be more straightforward, however, simply to refuse to buy the additional Soviet gas. Moreover, many Soviet oil and gas projects are not directly export-oriented, even though they indirectly contribute to the expansion or maintenance of Soviet oil and gas exports.

6. In our opinion, the only criterion which has a reasonable chance of justifying additional controls through COCOM is the impact on Soviet military capabilities. What is needed is systematic studies of the industrial and technological requirements of present and future Soviet weapons systems, on which a start has been made in NATO. Such studies could pave the way for substantial additions to the COCOM list. These additions may include some oil and gas equipment, but this would not be the main thrust. The studies could presumably be undertaken within COCOM, or alternatively in NATO, so long as there were agreement to use them in COCOM as evidence of the need for additional controls.

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